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Israel and the Palestinians:

the economic rewards of peace?

by

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About the author

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Israel and the Palestinians: the economic rewards of peace?

The economic aspects of the series of agreements between Israel and the Palestine Liberation Organisation (PLO) in the last eighteen months have been the focus of considerable international attention.

It was assumed by participants and observers alike from early on that the political success or failure of the Palestinian Authority would depend on its ability to deliver both immediate economic relief and long-term development prospects for the Palestinians. The Israeli government, meanwhile, could sell the idea of pseudo-territorial compromise domestically by dangling economic carrots such as the dismantlement of the Arab boycott of Israel, regional cooperation and integration, increase and diversification of international trade and a wave of peace-inspired new foreign investment.

Reconstruction of occupation

This paper examines the economic repercussions of the Oslo Accord between Israel and the PLO and subsequent agreements (the Paris Protocol and Cairo Agreement) from two perspectives. The agreements' most direct economic implications concern the details of the new relationship being established between Israel on the one hand and the Palestinians on the other. This paper argues that the contents of the agreements, together with the development of new facts on the ground, constitute simply the reconstruction of occupation in a way which offers some economic improvements to the Palestinians but little hope for long-term genuine sustainable economic development, and that the agreements cost relatively little to Israel in economic terms and indeed contribute towards Israel's own economic restructuring.

The less direct economic effects of the agreements are to be felt in both parties' relations with the rest of the region and the entire international community. An examination of developments since the Oslo Accords shows that Israel has already been amply rewarded for its 'concessions' (the term is used here with great reservation) and a momentum has been initiated which may well result in a high degree of regional cooperation, a lesser degree of regional integration, the virtually complete rehabilitation of the Israeli political and economic profile, but potentially the marginalisation of Palestinian cantons in an enlarged Israeli state, with little or no Arab or international interest in the justness or viability of their final status.

Creation of illusion

A false optimism has clouded the reality of the agreements reached. An illusion has been created, fostered by economists eager to emphasise the opportunities presented to Israeli, Arab, European and international capital, that the Palestinians have been offered everything necessary to rebuild their economy through a combination of Israeli compromises, enshrined in the new customs union, and generous international donor aid. From here on, Palestinian economic development should be a sure thing, were it not, they say, for an intransigent, incompetent and autocratic PLO élite.

The other parties involved, meanwhile, must press ahead with greater concerns - regional cooperation, regional development, peace agreements and political normalisation.

The reality is very different. The agreements basically constitute a new, although admittedly less severe, form of Israeli economic domination of the occupied territories. The occupied territories are to be allowed sufficient economic growth to absorb an acceptable level of Palestinian labour, reduce political tensions and revive a Palestinian market. Genuine, sustainable economic development, however, requires both national Palestinian political development and autonomous economic decision-making, both of which are now clearly off the Israeli agenda. The final status of the occupied territories has been clearly pre-empted by Israel in its own favour and the best that the Palestinians may hope for is to exchange political capitulation for a moderate level of improved standards of living.

This has all been possible because of two international failures: first, the international community has failed to insist that economic and political development in the West Bank and Gaza Strip should go hand in hand; and, second, Israel has been speedily rewarded, both politically, but more importantly economically, for its participation in the process, without regard for its own failures to fulfil either the spirit or the letter of the Declaration of Principles.

New economic realities

In many ways, it was new economic realities which brought Israel and the PLO finally to reach an agreement. Two of these realities predominated. On the one hand, the occupied territories faced rapid economic deterioration which was leading to political chaos and destabilisation. The PLO, in dire financial trouble after the 1990-91 Gulf War, was unable to compete with rising Islamic-based and externally funded opposition within the occupied territories.

Israel, meanwhile, required a speedy accommodation which would reduce the security burden on its own finances, absolve it of direct responsibility for the economic deterioration but allow it to maintain political and strategic control. In other words, it had to seek a new way of making a once-profitable occupation work for Israel.

The occupation had been profitable for Israel. There is plenty of reliable documentation which demonstrates that Israeli occupation policy had been designed deliberately to under-develop the Palestinian economy. Severe restrictions on finance, production and trade had reduced the occupied territories' domestic employment capacity, while the Israeli economy had been able to make great use of a cheap, unprotected Palestinian labour force.

Progressive net transfer of wealth

The result was a relationship of economic dependency with a progressive net transfer of wealth from the occupied territories into Israel. Profound structural imbalances within the Palestinian economy emerged such that it served primarily to complement and supplement that of Israel and relied increasingly for its survival on labour remittances, consumption and services rather than production. The economy was, moreover, used by Israel as an instrument to control the population and neither institutional nor political development was allowed if it threatened to challenge absolute Israeli authority.

By the late 1980s, however, the occupied territories were beginning to appear a costly liability for Israel. The cost of security as a result of the *intifada* had soared while the taxable base diminished along with an impoverished consumer market. Closures during the *intifada* and the Gulf War had begun to adjust Israelis to the idea of substituting new Soviet immigrants or foreign workers for Palestinian labour, and the slow but inevitable drive for economic liberalisation meant that guaranteed markets were no longer considered the answer for Israeli trade. In other words, the occupation was no longer serving the changing economic needs of Israel, but was still essential for political reasons.

The occupation therefore had to be restructured so that the benefits of political control were maintained, while the responsibility for economic conditions was passed to the Palestinians themselves. Although the West Bank still had significant political, strategic and economic value to Israel, the Gaza Strip - exhausted of resources, riddled with unemployment and chronic poverty, had become a liability, costing much in terms of security requirements and international censure, but no longer offering much of a market. It was better for Israel to maintain control and prevent competitive development but allow sufficient economic growth to reduce unemployment through domestic channels.

Thus, after the Gulf War, the Israeli Civil Authority adopted a new policy aimed at stimulating employment opportunities in the occupied territories themselves. In March 1993 the International Labour Organisation (ILO) reported:

> Measures include tax facilities for investors, the establishment of investment centres and industrial parks, the lowering of certain fees such as those paid to cross the Jordan Bridge, and steps taken to

allow the strengthening of the local banking system. These measures, however welcome, have had no major impact so far nor can they be expected overnight to make up for years of neglect.[1]

Moreover, of the $39 million 'Israeli Government participation' in the Israeli Civil Administration budget of $306 million, most, if not all, was to come from the so-called 'equalisation fund', made up of taxes and deductions from the salaries of Palestinians working in Israel. UNCTAD, in its assessment of the apparent shift in Israeli policy, noted that Israel still pursued a strategy of economic control and that '...the new approach was in line with the basic economic policy followed by Israel since 1967 which called for a maintenance of the established subcontracting relationship between the Palestinian market and the Israeli market under more flexible terms.[2]

The occupation renegotiated

The Oslo negotiations provided Israel with the opportunity to renegotiate, as it were, the economic aspects of the occupation. Four of the 17 Articles of the September 1993 Declaration of Principles on Interim Self-Government Arrangements referred directly to economic arrangements, as did Annex II, the Protocol on Israeli-Palestinian Co-operation in Economic and Development Programmes and the Protocol on Israeli-Palestinian Co-operation Concerning Regional Development Programmes.

The essence of the Declaration of Principles in economic terms was that some of the economic functions of government would be passed to a new Palestinian National Authority (PNA). Others would be exercised by this PNA in cooperation with Israel through an Israeli-Palestinian economic cooperation committee. While the PNA would assume direct responsibility for education, culture, health, social welfare, direct taxation and tourism, they would be subject to Israeli 'cooperation' in the more strategic areas of water, electricity and energy, financial development, transport and communications, trade, industry, environment, labour, media and the hunt for international aid and finance. Notably, Israel divested itself of the expensive functions of government but retained its influence on matters directly related to economic development.

The Declaration of Principles sought further to link projected development in the occupied territories to a regional economic development programme which would link Israel into a network of regional trade and cooperation and end the Arab boycott. Such a regional economic development programme would supposedly mobilise the resources of neighbouring countries in support of the Palestinians' own development efforts and contribute to regional security and development as a whole. In other

[1] International Labour Conference, 80th Session, *Report of the Director General*, Appendix II.

[2] *Prospects for Sustainable Development of the Palestinian Economy in the West Bank and Gaza Strip*, UNCTAD/DSD/SEU/2, 27 September 1993, Geneva.

words, after Israel had impoverished the Palestinian economy, the region as a whole would pay to put it back together again.

Burden of responsibility transferred

The economic value of the Declaration of Principles for the Palestinans was the establishment of the principle that they should exercise authority over their own economic affairs and that economic development would no longer be deliberately denied them. Less media attention was devoted to the proportionately greater economic benefits of the Declaration of Principles for Israel. While maintaining effective control over, and occupation of, the occupied territories, including a virtual veto over the activities of the PNA through a network of joint committees, Israel had passed the burden of responsibility for the economic welfare of the Palestinians to the Palestinian Authority, international donors and the private sector. It had also initiated the end of the Arab boycott, reassured US and international capital of its own security in the region and reversed much of the bad publicity which its policies had excited in recent years.

The PLO responded by referring to its own $11,600 million, seven-year investment plan for the West Bank and Gaza Strip. Like most proposals espoused by international agencies such as UNCTAD and the ILO, or academic groups like the Institute for Social and Economic Policy in the Middle East at Harvard University in the US, which produced a comprehensive study of the economic development needs of the occupied territories, the PLO plan emphasised the need for free trade between Israel and the occupied territories, as well as the need for regional integration and a strong investment role for the private sector. A short-term priority would be job creation and the maintenance of employment for 100,000 Palestinians in Israel. New legal and financial arrangements would be required, as well as large and diverse foreign aid contributions. The creation of new infrastructure, and improvement of existing infrastructure, were immediate priorities.

With the question of development strategy top of the agenda, the World Bank hosted a donors' conference in Washington, US, on 1 October 1993. Since it was estimated that public investment needs during the first ten years of Palestinian autonomy would reach $2,800 million, of which $1,100 million would be needed in the first five years, it was clear that international aid and finance would be critical to jump-start Palestinian economic development and to provide the short-term political improvements which would sustain popular Palestinian support during the transition period.

Emergency assistance programme

Together the World Bank and Palestinian representatives devised an Emergency Assistance Programme, or EAP, which was to provide a framework for channelling donor support, with the aim of achieving tangible benefits for the population 'quickly, equitably and efficiently, while laying the foundation for sustainable development over the long term.[1]

Already the international community was basing its response on two faulty premises. The first was that economic development resulting from aid and loans could be utilised successfully without reference to the new overall economic relationship between Israel and the occupied territories which at that stage had still to be worked out. Since the existing relationship was largely responsible for the underdevelopment and impoverishment in the occupied territories, only a complete reversal of the rules governing that relationship could remove structural obstacles to development. Secondly, the function of the aid was political - to support the Declaration of Principles and the peace process - not to promote economic development for itself, regardless of the agreements.

The cost of the proposed EAP was initially estimated at $1,200 million. About half of this was for public investment, and a quarter to support the private sector while incremental and start-up costs accounted for 19 per cent and technical assistance for 6 per cent.

At a donors' consultative group meeting in Paris on 16 December 1993, financial pledges were given for a total of $2,400 million, to be paid in monthly instalments of $10 million for the five-year transition period of the Declaration of Principles. It still remained, however, for agreement to be reached between the PLO and Israel on the precise economic arrangements for Palestinian autonomy. The talks, which began in Paris in mid-November 1993, did not reach a conclusion until 24 April 1994, when the Protocol on Economic Relations was signed.

Trade at the heart of talks

Trade was at the heart of the talks, with the Israelis demanding that the Palestinians should 'harmonise their tax and customs regime with the high levels in force in Israel, which reflect Israel's protectionist policies and the government's need to raise substantial revenues to meet its public expenditure.'[2] The Palestinian argument was that such a customs union would make imported goods too expensive for Palestinians and Palestinian exports too expensive for their Arab neighbours, and would drag the Palestinians into protectionism against their will.

Instead they wanted free trade and movement of goods and people between Israel and the occupied territories, but with the Palestinians being given the right to decide their own levels of customs duties and tariffs at a rate lower than those imposed by Israel.

The core issue here was Israel's wish to prevent the occupied territories from becoming a conduit for the import into Israel of cheap goods from elsewhere, with which Israeli products and importers could not compete. While Israel was prepared to allow Palestinian products unhindered access to its markets, it would have to impose duties on

[1] *Finance and Development*, September 1994, p. 7.
[2] *Financial Times*, 21 October 1993.

goods from the occupied territories if they were imported from elsewhere.

The Palestinians, who have a profoundly weak productive base, recognised that they would have little to export to Israel - with the exception of agricultural products - unless they had imported at least component parts or raw materials from elsewhere and used low import duties to give them a comparative advantage in the Israeli market. Israel was unafraid of Palestinian home-based competition. It estimated that Palestinian agricultural imports in a customs union would cost Israel at most 5,000 jobs, while the terms of the customs union would mean that Israel could reserve a significant part of the Palestinian market for its own, mostly consumer, exports. Even so, in deference to its own agricultural lobby, it finally agreed a customs union that included a degree of protection for Israeli agriculture. The Israelis also pumped an extra $100 million in subsidies into their agricultural sector as compensation.

Customs union established

In the end Israeli wishes prevailed. A customs union was established between Israel, the West Bank and the Gaza Strip. With the Israeli import tariff, other trade taxes, import licensing and standards have all been accepted by the Palestinians. The three exceptions to this are:

1. Six agricultural commodities are subject to quantitative restrictions on their import into Israel from the occupied territories: eggs, poultry, potatoes, cucumbers, tomatoes and melons - the quotas being phased out by 1998. The two sides also agreed to limit milk production to domestic consumption needs and not to export milk to each other.
2. The Palestinian Authority is allowed to establish its own import policy and tariff structure for certain products and commodities from third parties, notably Jordan and Egypt.
3. The Palestinian Authority will determine customs duties and taxes for goods imported for the Palestinians' own development programme (such as capital equipment and wood), on vehicles and petroleum products. Petrol prices must not be more than 15 per cent lower than in Israel to protect the Israeli petrol market.

The benefit of this agreement to the Palestinians is access to Israeli markets that had previously been denied to them (although still with some restrictions). The agreement diversifies trade and enables the occupied territories to export to a wider range of customers and to import some goods from the cheapest sources. Any jumping for joy, however, is premature. It is possible that Palestinian agricultural exports to Israel will enjoy some long-term comparative advantages, although the Israelis are likely to keep control of high-tech, high value-added, highly irrigated exotic fruit and vegetables and flowers.

Agricultural capacity over-estimated

The Palestinian agricultural capacity is constantly over-estimated by Israel, which ignores the profound problems of theft of land (by Israel - so far 70 per cent of the West Bank and 60 per cent of Gaza and usually the most fertile land), inadequate access to water and neglect of the soil because of the cost of fertilisers and soil treatments. The economists' dreams of a restored agricultural economy dissolve in the face of the reality of a deeply retarded and insecure agricultural base.

Likewise, Israeli manufacturing industry has little to fear from the Palestinians, who cannot compete with Israel's sophisticated, capital intensive industries. The Palestinians will remain subcontractors and assembly workers, providing the goods that Israel can re-export. Recent talks on industry have resulted in precisely these arrangements being planned for six industrial zones to be created along the borders which will combine Israeli industry with cheap Palestinian labour.[1]

The agreement did not address the issue of subsidies and non-tariff protection of some Israeli sectors. The Israelis retain the right to collect import taxes, although this money will be remitted to the Palestinian Authority according to the 'destination principle'. Most importantly of all, from the long-term perspective, the Palestinian Authority is denied independence in economic decision-making. Thus, for example, the Palestinians have been forced to accept a Value Added Tax (VAT) level of 15-16 per cent, just 1 per cent below Israel's and much higher than the Palestinians wanted. The thorny but critical issues of the return of land, phosphate reserves and water resources remain unaddressed.

Financial management

The Palestinians had made it clear that they wanted an independent central bank with full powers to issue a currency, control licences, hold the reserves of commercial banks, and direct monetary policy. Israel opposed such an obvious display of sovereignty but agreed to the creation of a Palestinian Monetary Authority to control and license the banking system in the occupied territories. A Financial Management Administration is being created to manage fiscal policy with overall responsibility for public revenue and expenditure. A Central Budget Office will prepare a budget annually in cooperation with UNRWA, non-governmental organisations (NGOs) and aid agencies, and will supervise the budgets of local authorities. There will also be a Central Treasury Office.

These offices, together with Palestinian Economic Council for Development and Reconstruction (PECDAR), will manage the administration of direct taxation and budgeting of the Declaration of Principles, always with reference to the Joint Economic Committee.

Two immediate problems have emerged:

1. Lack of appropriately trained staff - but administrative capacity is expected to increase rapidly given

[1] *Financial Times*, 13 February 1995.

the Palestinians' high educational levels and approximate skills.

2. The tax base is small and cannot afford the kind of taxes needed for start-up and investment costs. The Palestinian Authority is therefore forced to make up budget deficits with external development assistance, since there is no capacity for domestic borrowing. The ability to service debts is as yet unproven and the alternative - the accumulation of domestic payments' arrears - has already proved seriously destabilising. To make matters worse, many Palestinians are unaccustomed to the idea of legitimate taxation, having been victim of Israeli penalties for so long. The Palestinian strategy of tax avoidance as part of the liberation struggle meant that Israel has collected in the last year just $90 million in taxes, an estimated fifth of the total due. The Palestinian Authority will find it difficult to retrain Palestinian pockets to taxation payment, and there is no provision for the repayment to the Palestinian Authority of all the money illegally extracted in both direct and indirect taxes from the occupied territories since 1967.

The new arrangements do make it possible for a new regulatory environment to be established by the Palestinian Authority. This may attract foreign private investment and has already attracted new banking ventures where they were previously forbidden, with all the accompanying opportunities for investment credit to Palestinian entrepreneurs.

The advantage to Israel is that it can now legitimately have access to Palestinian savings and the circulation of Saudi, Egyptian, Jordanian and diaspora Palestinian capital now flowing into the occupied territores' banking system. Through joint ventures it is gaining access to markets previously denied to it and acquiring partners from countries previously unwilling to do business with it.

Labour - the thorniest issue

In many ways labour is the thorniest but most critical issue in Palestinian-Israeli economic relations. The Israeli government claims that Palestinian labour in Israel represents a security threat, while development planners agree that at least 100,000 Palestinians must continue to find work in Israel if the Palestinian economy is going to have a chance of recovering.

The existing economy cannot possibly absorb these workers, let alone the 15,000 new workers joining the labour force each year. Employment in Israel is a vital source of income for the Palestinian economy (about 30 per cent of national income) and the recent closures have been an effective threat, forcing the Palestinians into an accommodating negotiating position.

While the agreement states that Israel will not seek to impose a ceiling on numbers working in Israel, or to impose obstacles to their employment, Israel has demonstrated a deliberately decreasing dependence upon Palestinian labour and a preference for excluding it from the labour market in practice. Between March and December 1994, 54,000 foreign workers from Eastern Europe (especially Romania), Turkey and the Far East were given work permits to take jobs previously filled by Palestinians.

These workers are even less protected than Palestinians (to the extent that the Romanian foreign ministry has been obliged to lodge official complaints) and can be deported at a moment's notice.

Israelis who agree to take these low-paid jobs are also being paid an extra $10 a day by the Israeli government and on 10 April 1994 the Israeli Prime Minister Itzhak Rabin himself said: 'We have to free ourselves from our dependency on workers from the territories. This dependency forces us to take decisions which put Israeli lives in danger. The long-term aim is to reduce dramatically the number of Palestinians working in Israel.' [1]

Policy of 'total separation'

Rabin has recently been describing this as the policy of 'total separation', justifying it on security grounds. The result will be the same: the deliberate breaking of the terms of the Protocol to exclude Palestinian labour from a labour market which has ruthlessly extracted maximum value from that same labour for 27 years. In February 1995, he relaxed the closure on the occupied territories to allow 15,000 workers back into Israel, most of whom are over 50 years old. This is totally inadequate for Palestinian needs and, far from reducing the security threat, the resulting deprivation in the occupied territories can only fuel violent opposition to the peace process.

In conclusion, it is fair to say that, with regard to the economic relationship between Israel and the occupied territories, the agreements do provide significant new opportunities for the Palestinians. Whether these opportunities can be realised depends, however, on several factors, including: the efficiency of planning; the availability of investment credit; the return of resources like water and land (or at least substantially improved access at affordable rates) and, most importantly, Israel's adherence to the letter of its own commitments.

Autonomous decision-making restricted

Israel has relinquished few substantive governmental functions and has severely restricted the autonomous decision-making capability of the Palestinian Authority. It has failed to provide guarantees against undue interference through the Joint Committee, has made no concessions to recompense the Palestinians for the asymmetry of previous relations and is closing its border to the Palestinians' most urgent need - jobs. Under these conditions, and bearing in mind Israel's continued pre-emption of the final status, private foreign investment - including diaspora Palestinian capital - is unlikely to see a great (profitable) future in the autonomous areas. The diaspora capital that is returning is being concentrated in construction, retailing and services, none of which contributes to the productive base of the area, although they do contribute to circulation of wealth. A negative impact of the returning capital,

[1] *Israel Radio*, 10 April 1994

meanwhile, is the inflation of property prices.

The failures of aid

On the issue of foreign aid, it is ironic that, while it took 27 years to reduce the economies of the occupied territories so thoroughly, the international community expected a massive turnaround in just a few months. It was assumed that the promised aid would translate into rising living standards quickly enough to offset the tensions that would inevitably emerge from the detailed negotiation of autonomy. When Israeli disengagement fell behind schedule, when elections failed to materialise and as Israeli closures strangled the lifeline of Palestinian income, foreign aid was still only trickling into the occupied territories and living standards were falling rather than rising. The result, not surprisingly, has been loss of public faith in the opportunities presented by the deal, and a rise in political tensions.

Foreign assistance-led development carries its own risks. The funds are not inexhaustible and are likely to be reduced after a relatively short time. The developing economy's system must be flexible enough to adjust to reduced flows, quick to develop its own productive sources of revenues and must not allow aid to over-inflate standards of living beyond post-aid sustainability (as has happened in Israel). It should use aid to complement rather than substitute domestic taxation, must not slide into an excessive debt burden and must concentrate on developing a legal and political system which can successfully attract and regulate private investment.

Most importantly, the foreign assistance must not become a tool for the distribution of patronage by an unaccountable political élite. And herein lies the current problem. The international donors accuse Yasser Arafat of refusing World Bank terms for accountability over the way in which development money is spent.

The donors insist that the spending should be supervised by the World Bank, with money channelled through an accountable Palestinian body inside the West Bank or Gaza. PECDAR was set up to fulfil this role. But Arafat has refused to delegate authority to the body and all contracts must be signed by him personally. He argues that the Palestinian Authority is not simply a financial agent but an authoritative body striving for sovereignty which need not be accountable to patronising external assessment. Meanwhile, his unwillingness to delegate, his distribution of economic posts on the basis of political payback and his refusal to take advice have all served to frustrate and alienate many capable Palestinian leaders.

The result is that, of $760 million in aid pledged for 1994, only $140 million had actually been disbursed by November 1994.[1] Emergency aid, released in small amounts, has covered the running costs of hospitals, schools and the police force, but donors have failed to release anything like the amounts needed for real development funding. The two US disbursements of $5 million in May and $4 million in October, were not

[1] *Financial Times*, 22 November 1994

enough even to cover the electricity bill owed by the Gaza municipality to the Israel Electric Corporation which was under threat of cut-off.

Terje Larsen (the UN Under-Secretary General for the Palestinian Territories) said in November 1994 that donor strategy had been a failure, that too much emphasis had been put on long-term projects at the expense of immediate relief from poverty. Although the aid package has indeed failed, the problem has been that donors failed to link the economic aid which would have supported improvements in the territories to political developments in the agreements.

Financial accountability is a principle characteristic of democratic government, but democratic, national, constitutional elections have been delayed in such a way that it is difficult to believe that they will ever take place. The political structures that operate under Arafat's leadership, and which will continue to do so unless credible elections take place, are based on patronage, political appointments and an unwillingness to delegate what little authority he has.

Problem of unaccountability

Israeli occupation has for 27 years deliberately prevented the emergence of a mature political system in the occupied territories that could fulfil donor demands; and it is still refusing to allow a democratic, accountable Palestinian National Authority to exist. This is the root of the unaccountability problem. Elections and political development of the Palestinian National Authority will provide the donors with the accountability they seek and must therefore be priorities in donor dealings with both parties.

The Palestinians are penalised for Arafat's shortcomings by the non-arrival of aid. The Israelis, however, suffer no such penalty for consciously making Palestinian political development impossible. This is because the international community has made the fundamental error of separating the international aid from the wider context of the deal, both economically and politically. While the international donors may not want to get involved in the terms of the negotiations, they are wasting their efforts if they don't.

This is evident when one considers that no amount of international aid will sustain the Palestinian economy if Palestinian workers are denied employment in Israel in the short and medium term. No amount of support for agriculture will help if the best land is progressively being expropriated. And if economic arrangements between Israel and the occupied territories discriminate against the Palestinians then aid money will never be used to its full potential. In other words, political and economic development are inseparable. This is no great revelation - but then this international aid was never meant to stimulate economic development *per se*, but rather to sustain a particular political process in the short-term. To be sure, aid agencies and field workers have had much greater and better aims at heart, but only governments can ensure the long term viability of a deal by holding both parties equally accountable.

Rewarding Israel

It is not surprising that Palestinians should lose faith in the peace process when, while they have been held so closely accountable for their own leadership's failures, Israel is being speedily rewarded for its part in the peace process, regardless of its own refusals to stand by its commitments.

Israel has not withdrawn its troops as promised (in spite of US commitments to pay for the withdrawal, worth up to $500 million on top of normal annual aid) and clearly is no longer prepared to do so. It has prevented the holding of national elections for the Palestine National Authority and is instead insisting upon marginal, municipal forms of elections that will create little more than administrators.

Israel has confiscated a further 16,750 acres of land since September 1993,[1] uprooted 15,000 olive trees, announced plans to settle a further 70,000 settlers in and around Jerusalem in the next two years (creating an 80 per cent majority of Jews in the city), approved a further 6,500 housing units for Israeli settlers in East Jerusalem and started a £267 million road building plan in the West Bank.

Regardless of the final status talks that are due to start not later than the third year after Oslo, it is clear that Rabin's talk of separation, which he claims is for security purposes, is really an apartheid system, whereby the agreements reached are used to legitimise the permanent annexation of the West Bank.[2] Palestinian population centres will become the new outposts in an essentially Judaised land, reversing the current situation.

The economic powers which have been passed to the Palestinian Authority are those which cost money: health, education, investment and so on. Those which have been kept by Israel, or under Israeli veto, are those which have strategic value. In the meantime, international aid will prop up the Palestinian economy, while Israel is released from any accountability for its own exploitation of the territories since 1967. In fact Article XXII, Section 1a of the Cairo Agreement of 4 May 1994, specifically relieves Israel of any responsibility or liability for any and all actions carried out by it within the occupied territories since 1967. In other words, the international community will pay money into a Palestinian account from which Israel has been withdrawing funds for 27 years, and will pay for those things which are the responsibility of a sovereign government, while Israel retains the privileges of sovereignty

This is a depressing scenario, but one which is being ignored by most of the parties involved in the current Middle East peace process. Israel has begun an impressive international rehabilitation exercise which is designed to secure its regional economic role, to encourage foreign

[1] *The Independent*, 5 January 1995.
[2] In January 1994 Israel announced that it would build a 64-km, 50-foot wide electronic security fence around Gaza, to cost $30 million, by April 1995. (*Arab Press Service*, 11 January 1994.)

investment to support the domestic economy, and to advance its national security. To give some examples:

1. The dismantlement of the Arab boycott, regional cooperation and regional integration

The journalist Avi Temkin said of the Arab boycott: 'since its inception [the Arab boycott against Israel] has been a relatively effective weapon. Official estimates put the damage caused by the boycott, mainly in its secondary and tertiary aspects, at some $40 billion. Even if this figure is inflated, the boycott was clearly effective in blocking the formation of working relations between Israel and multinationals, from Europe and Asia in particular.[1] Indeed, it was the block on international, rather than regional, trade which created most problems for Israel.

By the beginning of January 1995, Israel had official relations with five Arab League member countries. In September 1994, the Gulf Cooperation Council states, led by Kuwait, had announced that they would no longer enforce the secondary boycott, and Morocco and Tunisia openly admit that they do not do so. Jordan and Egypt both now have peace agreements which prevent them from applying an economic boycott of Israel. Morocco and Tunisia have opened formal channels with Israel (liaison and interests' sections in Tel Aviv) and Oman has made some advances in that direction (although it has not as yet opened an interests section). An oil pipeline project with Qatar is now under way and Djibouti has agreed to normalise relations. Bahrain has announced that it, too, is seeking diplomatic ties and the GCC as a whole will begin sending tourists to Israel in the summer of 1995.

Although Saudi Arabia has held back somewhat in leaving establishment of diplomatic ties until full peace has been established, it has opened its airways to flights of the Israeli airline *El Al* and Saudi diplomats made a point of meeting Israelis at a business conference in Aspen, Colorado, United States, in November 1994. The *Israeli Telegraph* - a business paper, is to be distributed in the Arab world in 1995.

This still leaves the primary boycott officially in place, but in effect it is being bypassed in several ways. The Casablanca Summit of Middle Eastern and North African countries in November 1994 signalled its end when 2,500 businessmen and government officials from the Middle East, North Africa, Asia, the US and Israel, gathered to discuss economic prospects. The Israelis produced a confident, glossy document outlining their perspective regarding the potential for regional cooperation which stated that Israel's goal is: 'the creation of a regional community of nations, with a common market and elected centralised bodies, modelled on the European Community', with three stages of bi-

[1] 'The Arab Boycott: prospects for dismantlement and its implications for the Israeli business environment '. Avi Temkin in *Economic Dimensions of the Middle East Peace Process*, Economist Intelligence Unit, 1994.

national or multi-national projects, international consortia and regional community policy.[1]

Already the first and second stages of this process are well under way, although it will still be a long time before the third can develop. Through the multilateral talks on the Middle East, projects have been established in the sectors of tourism, environment, water and energy resources which draw governments and the private sector into economic cooperation.

Moreover, so-called 'secret' Israeli exports to the Arab world, via Italy, Greece and Cyprus - among others - already amount to over $500 million.

The common market perspective is being heavily promoted by the European Union, which has something of a bee in its bonnet about promoting itself as a model of economic perfection.[2] In a United Arab Emirates' chamber of commerce report in April 1994, the point was appropriately made that while Arab states may have little to fear from Israel in a common market framework, they would do better first to integrate their own economies.

Economic disparity

At the moment there is great disparity in the relative strengths of the Israeli and Arab economies. While the Arab world represents over 240 million consumers, Israel offers less than 6 million, yet its industry and agriculture are more sophisticated than those of Arab states. Israeli output is unlikely to 'swamp' Arab markets as the gloomier Arab commentators predict, but it will have significant advantage over Arab competitors.

The reality should also be faced that common markets require a degree of democratic and open government that simply do not exist in most Arab states. It could be appropriate to leave the common market goal until the Arab economies are more successfully liberalised, politically stable and economically competitive, in which case Israel should not hold its breath waiting.

The fact remains, however, that at the level of government-to-government cooperation the Arab boycott is increasingly meaningless, while private business has a rosy vision of the opportunities awaiting it in new regional economics. A good example is the ambition of the Israeli telecommunications company Bezeq to break into the Arab telecommunications market on the back of the new direct lines being established between Israel and some Arab countries.

2. International trade and investment

By August 1994, Israel had announced that 20 countries had established diplomatic relations with it since the Oslo Accord. More have followed since. In October 1994 Rabin visited China, Indonesia and Singapore to set up new trade (including arms' sales) deals. Many Asian countries, although not tied to the Arab boycott, have simply

[1] *Development Options for Regional Cooperation*, Government of Israel, October 1994.

[2] See, for example, *Communication from the Commission to the Council and the European Parliament: EC Support to the Middle East Peace Process*, Com (93) 458 final, Brussels, 29 September 1993.

ignored Israel in the past,[1] some like Indonesia refusing even to open diplomatic ties. Although new links are being developed between Israel and South America (with Uruguay and Venezuela for example) and Central Asia, East Asia is critical to Israeli aspirations to be a new Middle East regional 'tiger'.

Vietnam has been courted (the first Vietnamese economic delegation visited Israel in December 1994) as has South Korea (which Rabin visited in December 1994). Rabin also visited Japan in that month, citing progress in the Middle East peace process and calling for more Japanese investment in Israel. The Japanese Securities Dealers Association authorised its members for the first time to conduct trading through the Israeli stock exchange and the Japanese international trade and industry minister offered training to Israeli managers and workers in Japanese firms.

The result of Rabin's Asian trips has been a sharp increase in Israeli exports to the region, which have improved steadily since before the Oslo Accord. In 1993 alone bilateral trade with South Korea jumped by 50 per cent. China, India, the Philippines and Thailand have opened their doors to Israeli exports, especially chemicals and fertilisers, as well as to defence-related goods. Japanese and South Korean firms have shown interest in investing in Israel and in setting up joint ventures there to export elsewhere.

3.Trade with the European Union

An EU Summit meeting in December 1994 agreed that the way was clear for negotiations to begin on creation of a huge free trade area, covering Europe, North Africa and the Middle East. The next phase of EU enlargement would include Cyprus and Malta, and Israel would in the meantime enjoy a special status in its dealings with the EU.[2]

Since Oslo, Israel has pressed for its previous status with Europe to be upgraded. It is calling for associate membership of the full European space, for full membership of the R&D community, for some of its products to be considered as EU products, for extended participation in public tenders in the EU and for improved agricultural quotas. The EU is offering an improvement to its 1975 trade accord with Israel. The new deal will include services as well as the status of special trading partner for both industrial goods and agricultural produce, and access to extended EU loan capital.

The Union sees its relations with Israel as essentially separate from its relations with the Palestinians, although it has taken an active role in encouraging Israel to recognise the Palestinians' national and political rights. The EU appears to assume that by drawing Israel into the economic sphere, it is providing the incentive and precedent for political improvements. But such a policy of letting economics lead politics

[1] Avi Temkin, op.cit.

[2] *Arab Press Service*, 3-10 December 1994.

has the reverse effect. Again, it can be argued that the party in the peace process which holds all the cards is being rewarded in advance for concessions it has not made, and is not likely to make, and with no political conditions attached. It will be interesting to note whether Israel's request for membership of the OECD, made in June 1994, meets the same response. In the meantime, Brussels considers the Middle East to be a testing-ground for its joint foreign policy capacity.[1]

4. Foreign investment and Israeli liberalisation

Israel has been described by a senior French banker as 'the most exciting story around at present'.[2] In recent years it has managed to combine economic growth (which averaged 5.5 per cent a year in 1989-93) with, until recently, falling inflation and unemployment. It has an experienced and highly educated workforce, a diversified and high-tech industrial base, an improving per capita export ratio, a higher sovereign currency debt rating (Standard & Poor gave it BBB+ in September 1993, rating it above Mexico, South Africa and Greece), a GDP per head comparable with those of New Zealand and Ireland and is expected to reach 'developed nation' status by the end of the century.[3]

Over a decade of major structural reforms is now beginning to pay off, mostly in the areas of financial and trade liberalisation, labour market reforms and market deregulation, and privatisation programmes seem to be finally getting off the ground. Israel has great hopes of attracting new foreign investment, both through its stock exchange and through direct investment and joint ventures.

The stock market, which is over 60 years old, compares with those of Indonesia and Argentina, with over 600 companies quoted on it in 1994. The market is now free of restrictions for foreign investors and the Israeli shekel is destined to become a fully convertible currency. Israeli companies are also quoted on the New York stock exchange, among others, and were last year viewed as having improving prospects.[4] New York brokers are advising clients to hold on to Israeli shares and describe them as carrying relatively little risk and being 'interesting', in spite of a recent bear market which has seen a 30 per cent fall in the Tel Aviv Stock Exchange (TASE) index.[5]

Ripe for peace dividend

Although Israeli companies have traditionally looked to the US for finance, European finance capital is also increasingly interested in a market which it sees as being ripe for the peace dividend. European banks are now competing for a co-ordinating role in the sale of state-owned

[1] See the *Jerusalem Post International Edition*, 17 September 1995, p. 6.
[2] *The Middle East*, February 1995, issue No. 242, p. 30.
[3] David Brodet, Israeli Treasury Budget Director, estimates that current income per capita of $14,000 will increase to $20,000 by the end of the century. (*Jerusalem Post International*, 10 September 1994.)
[4] The US is by far the largest non-domestic buyer of Israeli equity, with 61 Israeli companies being traded on Wall Street, with a total capitalisation of $8,700 million. See *Financial Times*, 16 February 1995.
[5] *The Jerusalem Post*, 8 April 1994.

enterprises, in particular the most recent 25 per cent stake in Bezeq. Until recently, they considered this to be a closed US market but they are now competing with the Japanese for the role of underwriters in a renewed privatisation drive that will, it is hoped, restore the fortunes of the stock exchange.

Mr Schlom Grofman, managing director of Africa Israeli Investments, which is proceeding with a global offering in 1995, has said that, despite the current weakness of the TASE, there is definitely '...a new environment in Europe since Israel signed peace treaties with Jordan and the Palestinians. European investors are looking at the new Middle East, and particularly companies like ours which reflect the business of the new region.'[1]

Likewise, the Big-6 accountancy firms[2] which control 95 per cent of the world accountancy market, have recently targeted Israel as a new and growing market for their services, the most significant factor in their calculations being the imminent easing of the Arab boycott. Mr Danny Doron, president of the Institute of Certified Public Accountants in Israel, said of this development: 'The firms are moving here on the belief that the peace process is a done deal.'[3] Previously they were reluctant to deal with Israel for fear of damaging their business with the Arab world.

Red Sea riviera?

Direct foreign investment has also responded to the peace process and Israelis are hopeful that certain sectors will profit quite nicely - and in some instances quite quickly - from this new source of capital. As well as governmental bilateral and multilateral projects in resource conservation, the energy sector, transport, water and the proposed Middle East Regional Development Bank, there are also new opportunities, especially in tourism, which is considered a highly attractive sector. A Red Sea riviera is a real possibility

A negative result of the upsurge in direct foreign investment in real estate is the surge in property prices, which has been fuelling recent inflation, although property in the occupied territories has actually decreased in value by up to 50 per cent as a direct result of the Oslo Accord.[4] Moreover, Israeli Foreign Minister Shimon Peres has complained that foreign multinationals are still shrinking from actually dealing with Israel because of the region's tensions.[5] This would appear to be a pessimistic interpretation given the level of international business interest in Israel at the moment.

The Palestinian perspective

It is important to mention here the Palestinian perspective on regional economic development which carries

[1] *Financial Times*, 18 November 1994.
[2] Arthur Andersen, Price Waterhouse, Ernst & Young, KPMG, Coopers and Lybrand and Deloitte and Touche.
[3] *Jerusalem Post*, 15 April 1994.
[4] *Jerusalem Post International Edition*, 27 August 1994.
[5] op. cit.

both risks and opportunities for them. The first risk is that, as Arab countries abandon the boycott and integrate into networks that include Israel, then, if Israel refuses to make any meaningful concessions in final status talks, the Arab states will be decreasingly willing to support the Palestinian position with economic leverage. Secondly, as Israel and its Arab neighbours initiate cooperative economic development projects on an inter-state basis, so the Palestinians may become peripheral to the whole business and the autonomous regions will, in effect, be an economic region of Israel.

The Palestinians can obviously benefit from Arab economic activity in the occupied territories and from an improvement in regional resource development and sharing. The Saudis, Egyptians and Jordanians are all, for example, offering banking and finance services within the occupied territories while a Red-Dead Canal option (linking the Red Sea with the Dead Sea) would relieve some of the pressure on water provision. But treaties such as that between Israel and Jordan threaten to squeeze the Palestinians out of regional cooperation. The two new crossings for traders provided for in the Israel-Jordan agreement, for example, one east of Haifa and one in the south, mean that the Allenby bridge near Jericho is being bypassed. Israel and Jordan are already reaching agreements on agricultural trade, tourist projects, training exchanges, soil erosion management, wastewater irrigation schemes, flood control, veterinary projects and environmental control, with the pace of their joint activity far exceeding that of either with the Palestinian Authority.

The Israeli Manufacturers Association has complained that liberal trade policy towards Jordan and the allocation of Most Favoured Nation trade status to it is putting Israeli industry and agriculture at risk from cheap imports, and is being used by the Israeli government as an instrument to control inflation at home. But Jordan is an agricultural importer to the tune of $700 million a year, and Israel is a keen potential supplier. Equally, Israeli markets will be exposed to Jordanian exports before the Palestinians have developed their own economy enough to compete effectively.

Status of Jerusalem

Already, Jordan and Israel have agreed on two issues that threaten the final status talks. Their agreement on Jordan's special relationship with Jerusalem pre-empts Palestinian claims to the eastern half of the city, which is the commercial and administrative heart of the Palestinian economy.

The second issue is Jordan's leasing of border lands to Israeli settlements which the Palestinians want dismantled or brought under their own authority. The settlements are built on illegally expropriated land which has never been compensated for and which the Palestinian economy can ill afford to lose. In January 1995, Rabin declared in a television address to the nation that separation did not mean division along the 1967 borders. Jerusalem would remain united for ever and, he said, 'the Jordan River would remain our [Israel's] secure border.'[5]

Another mountain to climb?

This is obviously not an exhaustive survey of the benefits and costs of the current peace process between the Israelis and Palestinians. It may even appear unduly pessimistic to many. But I hope it has served at least to clarify some of the inequalities that have emerged in the new economic relations and to demonstrate that when Shimon Peres said of the Paris talks on economic arrangements that the Israelis were in effect negotiating with themselves, he was close to a painful truth.

The Oslo Accords have opened a Pandora's box of new economic possibilities. It seems, however, that despite the fashionable optimism that considers the Palestinian problem to have been virtually erased by a generous international community and an economic protocol on paper, in reality the Palestinians are only at the base of yet another mountain to climb. The Israelis, in contrast, have taken a quick helicopter flight to the top of the mountain and are busy peering through binoculars at the lands of opportunity ahead.

Israel's 'coming out party'

They have restructured the occupation, not ended it. They have established a new pseudo-legitimacy for their continued control over, and settlement in, the West Bank and Gaza Strip, underpinned not least by the frankly ridiculous concessions made by the PLO in Cairo.

They have unburdened themselves of the financial costs of rescuing the Palestinian people from economic devastation by passing the bill to the international donor community, foreign NGOs, UNRWA and the private sector. They have ensured that the Palestinian economy may to some degree recover, but never seriously compete. And they are in the process of staging their international economic 'coming out'[1] party. That is not to say that, in the short-term, they will not have to make some concessions in developing trade relations with both the Palestinians and the wider Arab world.

When a presenter gives a paper as full of criticism and pessimism as this, it is only fair that the audience should demand answers to questions, solutions to problems. I would repeat a point made earlier, that only political concessions by Israel, and the political development of the Palestinian Authority via national constitutional and democratic elections, can create an environment more conducive to mutual, equal economic gain.

[1] *Arab Press Service*, 21-28 January 1995.